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Government Contracts Update

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Lessons from the *Agility Defense* Case: Severing Affiliation with a Suspended Contractor

Affiliates of government contractors involved in suspension and debarment proceedings should note the recent decision in *Agility Defense and Government Services, Inc., et al. v. U.S. Department of Defense, et al.*, No. CV-11-S-4111-NE, 2012 WL 2480484 (N.D. Ala. Jun. 26, 2012). In *Agility Defense*, the U.S. District Court for the Northern District of Alabama confirmed that the government may suspend a government contractor solely on the basis of being affiliated with another suspended government contractor. However, without initiating any further legal proceedings against each affiliate, the government's suspension may last only 18 months. The court also reviewed the means by which affiliates can sever their ties with suspended contractors.

Following *Agility Defense*, any government contractor or affiliate facing a suspension or debarment should consider:

- how to sever an affiliation as described in the case; and
- how long their current suspension has lasted. (If it has lasted longer than 18 months, the Government must have initiated further legal proceedings against each affiliate.)

The Decision

The *Agility Defense* decision focused on "affiliation" under the FAR suspension and debarment regulations. Under FAR 9.403, business concerns, organizations, and individuals are "affiliates" of each other if, directly or indirectly, (1) either one controls or has the power to control the other, or (2) a third party controls or has the power to control both. Some indicia of control include:

- interlocking management or ownership;
- identity of interests among family members;
- shared facilities and equipment; or
- common use of employees.

A business entity organized following a suspension, debarment, or proposed debarment, which has the same or similar management, ownership, or principal employees as the suspended or debarred entity, also falls under the definition of "affiliate."

Efforts to Sever Affiliation

The plaintiffs in the case included Agility Defense and Government Services, Inc. (Agility Defense) and its subsidiary, Agility International, Inc. (Agility International). Agility Defense itself was a subsidiary of Public Warehousing Company, K.S.C. (PWC), which was suspended in 2009 after being indicted on allegations of defrauding the government. Based on their affiliation with PWC, Agility Defense and Agility International were suspended by the Defense Logistics Agency (DLA). In an effort to sever the affiliation, Agility Defense proposed a "managed buyout." Under the buyout proposal, the management of Agility Defense would resign their positions with PWC and create a new holding company. The new holding company would purchase a 60 percent stake in Agility Defense. PWC would have a minority interest in Agility Defense, but would have no voting or management authority over Agility Defense while PWC remained suspended. DLA rejected the proposal.

Notably, however, other subsidiaries proposing similar buyout arrangements had their suspensions lifted after amending their respective operating agreements. For instance, DLA lifted the suspension of AFH Fuel Services, which, like Agility International, was a subsidiary of Agility Defense. The AFH operating agreement was amended to keep Agility Defense in a minority ownership position (44 percent) and to remove the authority of Agility Defense to appoint one of the three managers of the company. Another subsidiary, LA3P, amended its operating agreement to remove Agility Defense from having any management and operational control over the company. DLA deemed these subsidiaries to have effectively severed their affiliations.

Clarifying the Meaning of “Affiliate”

In ruling against the government, the court also provided an expansive view of the term “affiliate” as it is defined under FAR 9.403. In defending its case, the government first argued that a contractor may be initially suspended based solely on its affiliate status to “prevent the primary contractor from shifting business to its affiliates, thereby allowing the affiliates to bid on government contracts and avoid the consequences of suspension from government contracting.” *Agility Defense*, 2012 WL 2480484, at *8. Limiting the suspension to 18 months, the government continued, would allow a suspended contractor to avoid the ongoing suspension by creating a new subsidiary, which would be eligible to compete for contracts.

The court rejected the government’s argument, stating that it presented a narrower interpretation of “affiliate” than its definition under FAR 9.403. The government based its argument in the case on the term “affiliate” applying only to corporate subsidiaries. The court pointed out, however, that “although ‘control’ is integral to the definition, both the parent and the subsidiary are considered affiliates of each other.” *Id.* “Thus,” the court concluded, “the regulation allows for the suspension of a parent company for the malefactions of its subsidiary, on the mere basis that the parent company is an affiliate of the subsidiary.” *Id.* Recognizing the definition of the term “affiliate” to be broader than merely “corporate subsidiary,” the court held that the danger of a “‘primary’ contractor shifting business to its ‘affiliates’ and, thereby, circumventing the consequences of suspension would seem to be much reduced.” *Id.*

“Affiliates” and Debarment

The *Agility Defense* decision briefly discussed debarment, noting that debarment of affiliates is a justiciable controversy. Affiliation applies to debarments as well as suspensions. For example, FAR 9.406-3 expressly states that a “notice of proposed debarment shall be issued by the debarring official advising the contractor and any specifically named affiliates” of a potential debarment and the reasons debarment is being considered. Venable will be monitoring agencies to see if they rely upon *Agility Defense* in the context of debarment.

How Government Contractors Can Address Suspension and Debarments

Government contractors and their affiliates under a suspension or facing the prospect of suspension or debarment should consider their options following the ruling in *Agility Defense*.

- An agency may suspend a contractor based solely on its affiliation with a suspended contractor. The government, however, must satisfy the requirements under FAR 9.407-1(c)(1), including:
 - Specifically naming the affiliate, and giving written notice of the suspension and an opportunity to respond.
 - Note also that affiliation is one of the prerequisites for supporting a suspension under FAR 9.407-1(c)(1). If a contractor can demonstrate it is not affiliated with the suspended contractor, it should include that information in its response to the suspending official.
- Certain types of “management buyout” arrangements have been recognized as sufficient to demonstrate a contractor is no longer affiliated with its suspended corporate parent or another suspended former affiliate.
- The government may not maintain a suspension against a contractor for longer than 18 months based solely on its affiliation to a suspended contractor. Legal proceedings must be initiated against the affiliate during that time period for the suspension to continue. Thus, a contractor suspended only by virtue of its affiliation to a suspended contractor should determine if the government has initiated any legal proceedings against it.

For more information on suspension and debarment issues, please contact **Rob Burton** at rburton@Vena

ble.com, **Dismas Locaria** at dlocaria@Venable.com, **Keir Bancroft** at kbancroft@Venable.com, or any of the other attorneys in **Venable’s Government Contracts Practice Group**.